



BCO

British Council for Offices
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MITIGATING OFFICE OBSOLESCENCE

The agile future

ABOUT THE BCO

The BCO is the UK's leading forum for the discussion and debate of issues affecting the office sector. Established in 1990, its membership base comprises organisations involved in creating, acquiring or occupying office space, including architects, lawyers, surveyors, financial institutions and public agencies.

The BCO recognises that offices don't just house companies, they hold people and so what goes on inside them is paramount to workplace wellbeing.

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EXECUTIVE SUMMARY

This report is the third in a series of guides designed to tackle and, importantly, exploit the thorny issue of office obsolescence. First, it sets out the international scrutiny afforded to office obsolescence in academic literature and practice-based research. It then responds with some practical guidelines on and solutions to office obsolescence alongside an appraisal of the wider socio-economic environment, which must be considered in any office-building change. It concludes with a set of recommendations for the industry, arguing that the working environment has changed forever – disrupted by new flexible business models – and that office landlords and investors must respond and adapt to this situation with their own agile solutions.

It is a common economic law and characteristic of cyclical property markets that physical supply lags business demand: of course, it takes considerable time to build buildings. However, it is increasingly important that those charged with the physical supply of office buildings should strive to bridge the gap between the short-term agile requirements of business demand and the longer term inertia associated with physical supply. That is why this report concludes with a set of agile-working principles that have been designed to sit alongside the BCO *Guide to Specification*, forming a platform for continuing office investment return.

The findings of this report are summarised below. ■



The nature of business has changed
and commercial office markets need to exploit this new environment



Uncertainty in office use
should be expected and consequently managed through iterations, anticipation and adaptation



Office building productivity
should be maintained through situationally specific strategies, processes and practices



Agility and adaptation
are prioritised over conformity in building use, specification and spatial strategy



Changing business requirements
are welcomed. Agile processes should be embedded in order to harness change for competitive advantage



User demand and existing tenant requirements
should be assessed at regular intervals, leading to the fine-tuning and adjustment of office development and management

INTRODUCTION

Albert Einstein allegedly quipped that

“If a cluttered desk is a sign of a cluttered mind, of what, then, is an empty desk a sign of?”

Albert Einstein

In a slightly broader context, what do obsolete office buildings tell us about the cities in which they reside, the landlords who own them, the investors that trade them, and the institutions of the commercial real estate markets that govern them? One way of considering this situation, is that empty offices provide

“A window into the soul of our shifting economy.”

Carter¹

Illustrating the magnitude of the situation, current research indicates that within 32 key regional centres across the UK, outside Central London, there is approximately 11.7 million ft² of obsolete office stock, where the building is no longer desirable or does not meet the present and future occupier requirements. This reflects approximately 27% of the total regional availability in these markets. Moreover, following the opening of the Facebook headquarters in California designed by Frank Gehry, Marc Kushner heralded the end of the office, arguing that social media is changing the way we consume the built environment. This statement is not necessarily as hyperbolic as it may first appear, as technology is increasingly pervasive and agile businesses and their employees now have the potential to work everywhere and anywhere. Similar flexibility is seen in contemporary lease arrangements, which are increasingly short and flexible. Unfortunately, there has been little comprehensive investigation into the incidence of office obsolescence in the UK, or its potential management or amelioration. Consequently, the emphasis by the BCO on obsolescence in recent years has been prescient. This report follows on from:

- *Can Do Refurbishment – Commercial Buildings of the 70s, 80s and 90s*, published in 2009²
- *Change for the Good – Identifying Opportunities in Obsolescence*, published in June 2012.³

Investigation of the exposure of commercial office property to the various pressures of obsolescence is vital, as many office buildings are frequently rendered redundant long before they become physically obsolescent.

In the worst situation, without intervention, office properties may become stranded assets, suffering unanticipated or premature write-downs, devaluations or conversions to liability ahead of time. This report argues that landlords, investors and market institutions need to adopt agile ways of working to remain in alignment with the contemporary needs of business. This requires developing an understanding of how buildings



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can be adapted but also conceding that office obsolescence is as much about traditional working practices as it is about the physical nature of the building – while the impact and benefit of location remains a continual concern.

Obsolescence is influenced by many factors and is a real and growing problem. This is likely to become more acute with increasingly dynamic occupier requirements, exacerbated by an institutional environment of shorter leases and more onerous legislation, which has the potential to accelerate the pace of legal obsolescence. For example, in 2018 certain office properties available on the market with an Energy Performance Certificate below Grade E will be under threat of legal obsolescence (this will be extended to all properties in 2023). The level of awareness of this situation is debatable, while an open question is present in relation to how prepared landlords and investors are for the impending minimum energy-performance standards due in 2018 and the more demanding requirements in 2023 when they will affect all stock, not just that available for occupation.

Obsolescence, however, is not restricted to vacant stock – this is only the most conspicuous manifestation of poor performance. Many companies occupy offices that do not meet current or future requirements and which they plan to vacate at the earliest viable opportunity. This form of obsolescence can be labelled as *grey space*, and it hides in plain view in most town, city and business park environments. Illustrating this situation, survey data from the BCO³ indicate that almost 60% of the space occupied by office users is ‘sub optimal’, and hence there is a significant amount of shadow obsolescence overhanging the performance of local property markets.

The implications are clear – we have too much obsolete office space in the UK. ■

REVEALING OBSOLESCENCE

Various researchers have examined office obsolescence, including studies on depreciation,^{4–10} the adaptation of vacant properties,^{11–20} mapping the characteristics of obsolescence,^{21–23} modelling the cyclical behaviour of the economy and property^{24–26} and the medium- to long-term rental adjustment process.^{27–35} In addition, professional practices regularly use relative vacancy levels (alongside absorption and take-up, rent and yield) to monitor the performance of local markets (see quarterly updates from international commercial real estate companies). At the same time, alongside the BCO, several of the same commercial real estate companies have published guides on the extent of obsolescence and how it can be tackled.^{36, 37}

The majority of this research and professional interest is notable for its proximity to recession (or just as the market starts to recover), as the agencies look for new income-making opportunities and vacancy levels are at their highest. An underlying argument in this report is that, while obsolescence is at its most pronounced during recession, the strategies for its mitigation exist throughout the property life cycle. In order to illustrate this proposition, throughout the remainder of this report we supplement our arguments with the opinions of commercial real estate professionals.

Figure 1 illustrates the drivers of obsolescence as they coalesce into depreciation, eventually concluding with the end of the building's economic life as income is no longer sufficient to cover running costs and generate a return. This conceptual model is supplemented by the definitions of the various types of obsolescence in Table 1. ■

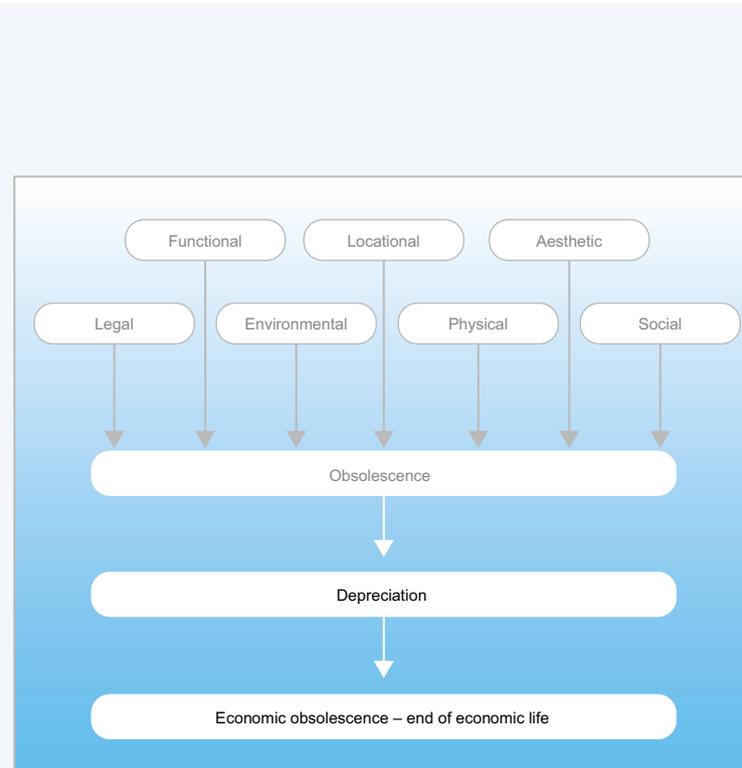


Figure 1
The obsolescence process

Legal	Environmental	Functional	Locational	Physical	Aesthetic	Social	Economic
Due to new or tighter regulation – fire regulations, equality Act, asbestos regulations, Minimum Energy Efficiency Standards (MEES)	Due to negative externalities – often associated with neighbourhood blight	Due to changing business requirements – often related to ICT or the simple disappearance of business demand	Due to the changing nature of the local economy – often associated with lower levels of rent, which damages the commercial viability of the office building	The physical deterioration of the structure, envelope and services	Influenced by current designs and tastes – prevalent in many of the modernist buildings constructed in the 1970s and 1960s	Due to current lifestyles and occupier expectations – historically this could be related to car parking but it is increasingly linked to access to amenities and walkability	The consequence of all the above – the office building no longer generates enough income to cover the cost of operation, intervention and rate of return

Table 1
Defining obsolescence

PRACTICAL GUIDELINE AND SOLUTIONS

First, although office obsolescence is an obvious concern for investors, it is important to note that obsolete office buildings also have many redeeming features and consequent opportunities for management.

Secondary and tertiary office properties (those most often associated with obsolescence), for instance, play an important role in the supply of business space. Such properties often provide fill-in space when the supply (and pipeline) of Grade A prime space has dried up, for example, following recession when development activity lags business demand or in response to structural shocks such as the Brexit vote (there is a clear and present risk that new Grade A office construction will stall following Brexit). Similarly, these buildings offer cheap start-up space for new businesses in the digital, creative and third sectors.

Figure 2 illustrates this situation using a traditional SWOT analysis, outlining the respective strengths, weaknesses, opportunities and threats that pervade obsolescent office stock.

MITIGATING OBSOLESCENCE

In academic debate and professional practice, the majority of emphasis has been on the physical adaptive reuse (academic) or conversion (practice) of redundant offices for alternative use. This is certainly a valid mitigation strategy. However, it is not the only technique available. The following sections of this report set out a holistic typology of mitigation techniques (alongside corresponding management strategies and degrees of intervention) that should be utilised within the context of the building life cycle (Figure 3).

ASSET EXPLOITATION

Asset exploitation involves getting the most out of the office asset. It preserves the office property in its current state in order to sustain its existing use and ongoing service provision. Research participants indicated that central requirements in this strategy are:

“Proactive managing agents who excel in good housekeeping and estate management. This should include forward planning, cyclical maintenance, and not dumping the costs on tenants in one go and considering shouldering the costs themselves.”

Head of office agency

Strengths	Weaknesses
<ul style="list-style-type: none"> • Lots of it (which means there is discriminatory choice) • Often have good accessibility/proximity to transport networks • Often in prestigious locations (town and city centre) • Convenient proximity to services and social amenities • Lots of obsolescent buildings still have identity recognition • Often have better parking provision associated with historical infrastructure 	<ul style="list-style-type: none"> • Market overhang (which means lots of availability) • Loss of rent combined with increased holding cost (opportunity to reverse and maximise) • Perception of functional redundancy (counteracted by the emergence of new technology such as Wi-Fi and flexible working practice) • Perception of economic redundancy (counteracted by central locations and strong rental structures)
Opportunities	Threats
<ul style="list-style-type: none"> • To change a negative story into a positive future (instead of empty property rate avoidance, promote a climate of new business entrepreneurialism) • Transformation (within and across use) • There has been a revalorisation of commercial office space – tenants want less of it and more from what they get from it • Traditionally, the agile tenant is small, creative and flexible and wants office space that reflects their needs, cultural tastes and status • These practices are increasingly influencing large organisations, for example the new Facebook, Google and Apple headquarters 	<ul style="list-style-type: none"> • Write-down of property book value • Empty property rates • Minimum energy performance standards • Uncertainty associated with the 2017 business rates revaluation exercise*

*This is proving both positive and negative. In prime areas, high property values are likely to be locked in, particularly in Central London and the South East. However, elsewhere the value of obsolescent assets is likely to fall (the last valuation exercise took place at the top of the market in 2008). This will make obsolescent assets more attractive in certain locations, typically in the North, as business rates will fall for tenants (and empty property rates for landlords). In Central London and the South East the opposite is true – conducting business will become even more expensive.

Figure 2
The opportunities and challenges for obsolescent office buildings – SWOT analysis



Figure 3
Obsolescence mitigation typology

There are three management strategies associated with asset exploitation: corrective maintenance, consolidation and disposal. Indeed, research participants indicated that asset exploitation exists on a sliding scale, beginning with corrective maintenance, as the office building begins to depreciate; typically this will take place in the near term at lease renewal. This then moves into consolidation, which involves economic rebranding and tenant incentives such as reduced rents and easy in easy out agreements, or tenants paying only the service charges related to tenancy. However, this can be difficult:

“In some cases, the ability of the property owners to let their property via aggressive discounting may be constrained as this would result in a technical breach of their loan-to-value covenant.”

Partner, investment and development

The final stage is disposal, when a property dips below an income threshold and the property is sold to realise the asset/site value and avoid management and operating cost. This is a valid strategy, but it must also be noted that this strategy causes a great deal of secondary commercial office vacancy. Large investment companies, typically the financial institutions, sell their assets as soon as they dip below a rate of return. One investment director referred to this strategy as ‘pump and dump’.

Therefore, these strategies are also related to the nature of office building ownership. Illustrating this contention, a national office agent indicated the inherent complication and potential opportunity in alternative ownership:

“A typical investor, in particular institutional investors, will only hold a property for 1–10 years ... not long enough to consider change in use. However, foreign wealth investors have a slightly different perspective, i.e. they are not necessarily looking for a quick rate of return, rather wealth protection, and such investors typically hold a property for longer.”

National office agent

In the first instance, this appears to be an opportunity for managing obsolescence. However, the same agent indicated that:

“Foreign wealth investors have not really moved out of Central London yet, although they are starting to look further afield. A greater challenge for obsolescence is their preference for status buildings of the highest specification. Foreign wealth investors are not interested in older buildings.”

National office agent



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Each of these techniques involves a degree of

“Wait and see what the market does.”

Investment agent

These options are often largely *laissez faire* in intent and in themselves represent a significant cause of obsolescence as landlords and investors await a better day for their assets, which may not arrive.

DEMAND REPOSITIONING

Demand repositioning involves ‘within use’ change and typically forms a bridging point to full conversion into alternative use. Research participants indicated that it is this scenario that is often ignored by landlords and investors, who often jump straight to the renewal or removal and redevelopment scenarios. Reflecting this situation, a head of office agency argued that:

“Repositioning is a consideration but is very difficult to justify in terms of achievable rent after completion of works.”

Head of office agency

The three management techniques are mothballing, repurposing and addition/creative demolition. Although mothballing is not considered a positive strategy (as it contributes to market overhang), it does constitute a form of repositioning, as the property has been consciously removed from its original purpose. This strategy allows investors and landlords to avoid high holding costs, such as running costs, and often runs hand in hand with an effective empty property rate avoidance strategy. However, the downside to this approach is that empty office buildings are costly to secure, may suffer from crime and anti-social behaviour and do not make any money for the landlord while potentially incurring empty rate liabilities.

Research participants indicated that mothballing is a significant cause of obsolescence as landlords and investors wait for or consider alternative futures. They indicated that this is because landlords and investors prefer to wait for better futures, rather than to actively go out and create the conditions for change themselves. Therefore, there is a disjuncture between mothballing and repurposing within current use, and the two techniques should not be seen as symbiotic. Proactively repurposing refers to the realignment of a given office asset with a new target audience. Reflecting this situation, in recent years, property companies like Bruntwood and Overbury have begun to specialise in the secondary office market.

Of particular prominence is the serviced office model. There is widespread consensus that prime offices are in short supply, and that there is a need for good-quality secondary fill-in space.

Indeed, there is growing acceptance that certain buildings will not be let exclusively to one tenant but rather they will be multi-let entities with transient tenancy. In these buildings, it makes sense for the landlord to control and maintain the common areas in order to always give the impression of a new building. This approach was pioneered by Regus but has increasingly been taken on by additional serviced office providers.

Participants in the office sector have generally been slow to accept the changing business landscape and have not changed their business models accordingly. For example, the long lease does not accommodate the short-term priorities of small businesses, which want easy in, easy out agreements and the ability to grow and contract quickly. Further demonstrating the bridging potential of demand repositioning and asset renewal, the small-business sector provides a useful means for further exploiting an office after first use and ahead of any major adaptation.

The third management technique is that of building addition and creative demolition, and is physical in nature. Research indicates that, in certain cases, adding extra size to a building can help to retain or attract new tenants, while the creative demolition of unwanted building elements was also deemed positive in relation to overall marketability. This is because in certain instances and locations businesses outgrow their premises. This finding formed an interesting contrast to the prevailing consensus in our research in relation to declining space requirements. It demonstrates that new business trends are not uniform but rather they are diverse. It is important to note that this trend is constrained by available expansion space and the planning regulations in relation to building mass.

RENEWAL

Our research indicates that, once asset exploitation and repositioning have been exhausted, there are only two options for obsolescent office properties: they are either adapted for an alternative use or they are removed from the property supply altogether. Reflecting this situation, the next obsolescence measure is that of renewal. There are two management strategies, notably meanwhile use and alternative use. Meanwhile use, as the name suggests, involves a temporary fix and is something that takes place in the interval between one use and the next. It is a positive version of the mothballing technique described in the section on repositioning (above) and describes the situation when office buildings are taken forward by entrepreneurs and community groups to be used for social and cultural purposes until they can be re-commercialised. This strategy helps landlords and leaseholders to enhance security, maintain the premises, lower the running costs of the building and improve the overall prospects for commercial reuse.

Considerable academic literature has sprung up in recent years around meanwhile use³⁸ but the technique has not as yet gained a great degree of exposure in practice. However, there is growing recognition of this technique and it is becoming a legitimate part of the obsolescence mitigation ordnance. The New Retail Quarter in Sheffield and the Harland and Wolff offices in Belfast have both utilised the meanwhile use technique to support and catalyse stalled urban regeneration projects. Indeed, the research participants reported that this is increasingly used to soften the overhang of obsolescent office property.

For example, Croydon Borough Council has created a meanwhile use strategy toolkit to encourage and enable the exploitation of Croydon's underutilised spaces with beneficial new uses.³⁹ The toolkit includes a generic meanwhile lease, an intermediary meanwhile use lease and a meanwhile use sublease, which can be used in negotiation with landlords. The toolkit also provides advice in relation to exclusion of tenure agreements, which acknowledge that the meanwhile use will move once a new use is in place. In many ways all of the strategies outlined in this model are meanwhile, but this specific technique is proactive and looks to exploit obsolescence rather than ignore it.

The next management technique, alternative use, has received most attention in academic and practice literature. It is possible for obsolescent office buildings to be adapted for various types of alternative use (reducing the incidence of obsolescence and vacancy), including housing, hotel, retail and leisure, sheltered accommodation and combinations of all these in mixed-use development. Indeed, the research participants indicated that, outside of Central London and the regional cores, normality in the future will be a mixture of uses, as landlords battle to generate income from their stranded assets. However, this needs to be balanced against the opposing view that:

“Mixed use/and regular change in use would frighten most of the industry to death as it would mean a fundamental revision of the way properties are valued and the way finance is lent out in terms of risk.”

Finance manager

This strategy improves and changes the physical and economic nature of the dormant office building and counters deterioration and depreciation. It can also take less time than redevelopment because it does not need as many preliminaries and does not necessarily require a formal planning application (especially in England following relaxation of Permitted Development Rights for office-to-residential conversion). The result is a shorter construction programme and increased recycling of cash flow and investment (from negative to positive), as return can be generated over a shorter time period. Moreover, it is also more environmentally sustainable due to the reuse of the carbon embedded in original building materials. Indeed, a leading architect stated that:

“Reuse can be cheaper than traditional demolition and rebuild. The actual construction costs, particularly in conversion to new use, are probably very similar ... but the prelims, planning, digging of foundations and time taken in new development increase these costs exponentially. So the cost and the viability of a project is really a question of time, turn around and momentum.”

Leading architect



Former Harland and Wolff headquarters building and drawing office, Belfast
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REMOVAL AND REDEVELOPMENT

The final vacancy strategy is removal and redevelopment (ultimately, most properties will reach this stage unless they have statutory protection, e.g. listing). These obsolescent office properties have no future in either present or alternative use and should be removed from commercial office supply altogether to make way for new development. It is important to note that this report does not argue for the retention of all obsolescent office stock. Rather, it contends that meaningful steps should be taken to prolong the asset life of office properties in order to maximise potential value before engaging in the costly and time-consuming process of demolition and redevelopment.

Where removal and redevelopment is straightforward, new construction costs can be far lower than conversion, and decision-makers need to be aware of this possibility. This is because not all renewal projects will be economically viable due to restrictive building characteristics, including difficult designs, adverse location characteristics, or prohibitive legislation and listing. However, the research participants indicated that demolition is also not a straightforward process:

“Who is going to pay for demolition when there is no obvious end use? Not the owner, the result is blight.”

Investment agent

There are two interrelated management techniques associated with this mitigation measure: demolition and deconstruction, and redevelopment. Deconstruction involves taking apart a building at the end of the life cycle in order for those parts to be reused elsewhere.

The inner circle in Figure 3 shows the magnitude of intervention involved in each obsolescent building strategy. The asset exploitation strategy involves low intervention and can mostly be covered under lease renewal or by sitting back and waiting for the market to recover or simply selling the asset. The repurposing strategy is associated with low to medium intervention, as it may involve a certain degree of physical intervention as new structures are added or an office building is remodelled to cater for multiple tenants. This may involve adding (or removing) partitioning and work to the entrance and

common areas to make the building friendlier to tenants and customers. Renewal is considered a medium- to high-impact intervention. Although meanwhile use can be relatively low impact (often led by an informal tenant), transformation into alternative use involves considerable physical intervention in the building structure, layout, façade, building services and aesthetics. Finally, removal and redevelopment is high impact and involves severe disruption. Therefore, it is expensive and there could be considerable delay in the final outcome.

Clearly, there are opportunities and challenges involved in each option. However, our research indicated that these challenges can be mitigated and opportunities exploited if the office building is seen as a dynamic process, rather than a functional asset, which needs to be managed across the entire building life cycle in order to extract continual value. Indeed, in a mixed-use future, office buildings could be a mixture of all four management strategies at the same time. Illustrating this situation, a leading architect commented that:

“In an ideal world the building will continue to evolve, certain parts will remain the same, some parts will be repositioned, certain parts will be changed into alternative use and certain parts of buildings will be demolished to make way for improvements ... why on earth should we see buildings as static objects?”

Leading architect

This section has considered the various strategies that can be used to exploit obsolescent office buildings, the associated management tools and the potential degree of intervention in each strategy. ■

MANAGING OBSOLESCENCE: CONTEXT

In any response to obsolescence, particularly conversion for new use, it is tempting to focus on the physical aspects of buildings, for example building size, height, depth, structure and servicing arrangements. These factors are certainly important, however our research indicates that the physical building exists within a much wider socio-economic context which influences both the management of the office property and the potential mitigation of its obsolescence. To account for this wider context, a PESTLE analysis was used to scan the contingent environment of office obsolescence.

A PESTLE analysis focuses on six key themes:

- political
- economic
- sociological
- technological
- legal
- environmental.

Figure 4 sets out the analysis and lists the ingredients that should be understood and considered in any response to office obsolescence.

POLITICAL ISSUES

The main political issues involved in the obsolescence of office buildings relate to central and local government. In the UK, this includes the attitude and buy-in from local planning authorities (and in the near future buy-in from new metro mayors and combined authorities) and the availability of financial grants and tax allowances to enhance the economic prospects of intervention. The availability of grants and tax allowances is a fundamental requirement in marginal economic areas where expensive intervention is difficult to justify. However, even during a time of austerity, financial incentives existed until recently. The Business Premises Renovation Allowance scheme started in 2007 (it closed on the 31 March 2017 for companies and 5 April 2017 for unincorporated businesses) and was designed to tackle empty business premises in assisted areas (defined by European Union rules on state aid) by bringing them back into use. Under the scheme, it was possible to obtain 100% capital allowances as a deduction against profits for the full cost of renovation. The major problem with this scheme was that so few knew about it.

Traditionally, building use classification has been seen as the number one veto characteristic in office reuse. The inability to agree change in use, through planning, stops potential reuse strategies at project initiation and frustrates the free market, which would otherwise determine the highest value at each site. Encouragingly, this issue has been relaxed in England,

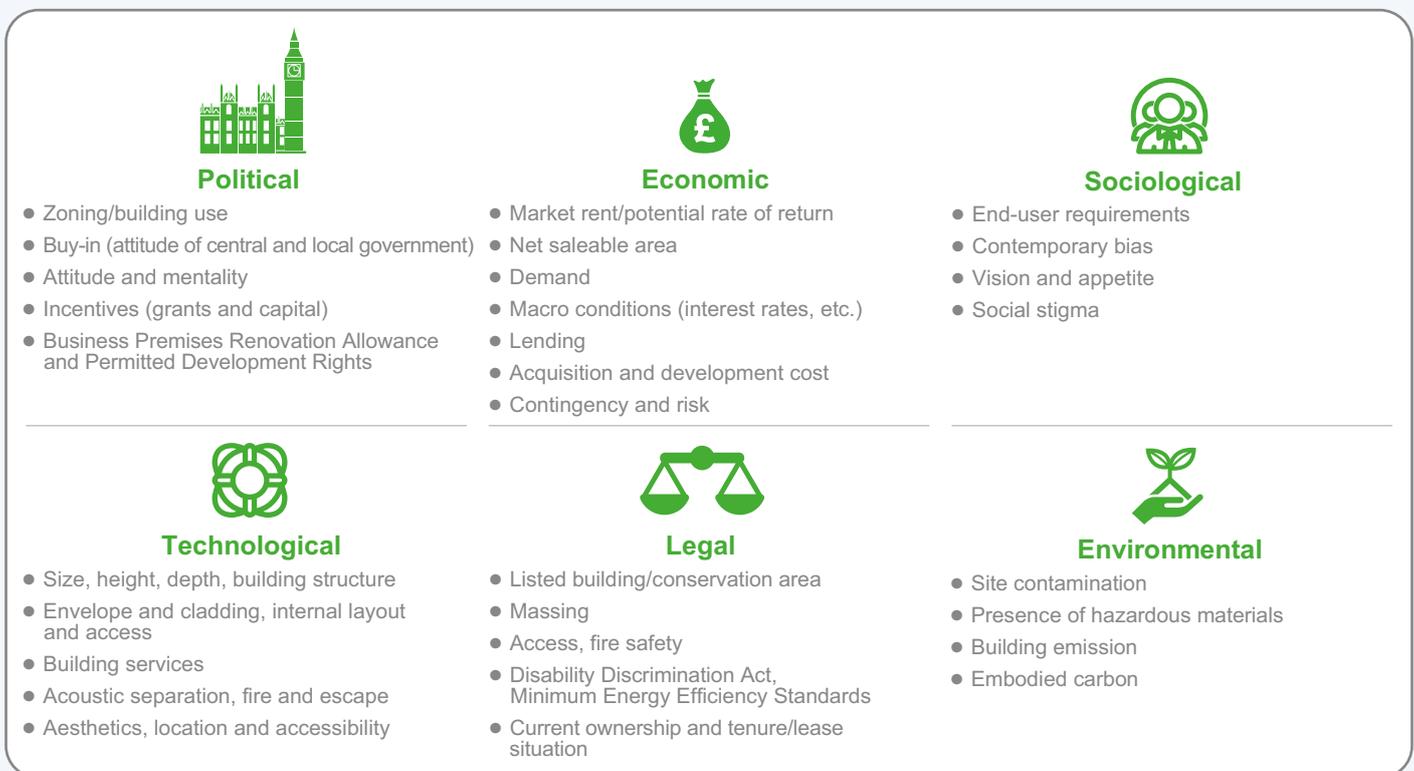


Figure 4
Mitigating office obsolescence
Source: adapted from Wilkinson et al.⁴⁰

after the 2013 relaxation of Permitted Development Rights for office-to-residential conversion. Yet, this move has not been unanimously embraced. Local authorities in England have managed to agree 17 time-limited exclusion zones prohibiting change of use (for example, Manchester and parts of Central London), indicating that in certain locations conversion is not a practical mitigation strategy (see the BCO 2015 report on office-to-residential conversion⁴¹). Before considering an intervention strategy, the latest local authority development plan documents should be consulted in order to understand the relevant planning authority's attitude toward the supply of employment premises in that area. In addition, the availability of government grants and tax allowance is a significant boost for the renewal strategy. Until very recently, before any intervention strategy was considered, it was important to check whether the building under question was in a European Union Assisted Area, as this defined where the Business Premises Renovation Allowance could be exploited.

ECONOMIC ISSUES

Table 2 summarises the economic considerations for each management strategy and can be used as a simple guide when appraising the economics of the various obsolescent office management strategies. For the purposes of discussion, the table should be read from top to bottom and left to right. The economics of the obsolescence situation is often skirted over, but no intervention strategy will proceed without economic viability.

Valuation method. Although not an obvious concern in determining viability, rather a method, research participants indicated that the assumptions underpinning the various valuation methods have inherent built-in assumptions that undermine the mitigation of obsolescence. The asset exploitation strategy, basically the 'do nothing' approach associated with the first years of occupation, will typically use an implicit investment valuation underpinned by the book value of the property. The other three strategies, because they are based on physical intervention, use the explicit residual valuation in order to arrive at either a land value or a projection of future profit. This makes sense because the actual costs of development, with respect to potential rent, need to be understood in order to calculate a realistic rate of return.

However, there is often considerable disjuncture between valuation methods. This is because the movement between investment and residual valuation necessitates an evaluation of real property value, which is often considerably lower than the original book valuation. The result is that landlords are not necessarily willing to accept new valuations (preferring the book value predicated on 100% rent) that underpin intervention, and prefer to mothball and wait for the market to improve or for the value of their capital asset to appreciate over time. This issue is particularly severe in high value locations where landlords can assume with a degree of certainty that their underlying land asset will continue to appreciate in value, hence the problem of land banking and its association with blight.

Gross floor space. With regard to the gross area, under the asset exploitation and repositioning strategies this area will stay the same. The exception to this rule is the addition of extensions or the removal of unwanted building elements. Both options have the potential to increase the value of the building. An extension has the potential to increase the net internal/useable area of the building, while creative demolition has the potential to remove unwanted parts of the building to increase the overall marketability of the potential product. Under the renewal strategy, the gross area has the potential to decrease or increase in line with the building project. Under removal and potential redevelopment, the gross area is unknown but a presumption can be made that it will be more efficient than the previous building use.

Net internal/useable area. The net internal/useable area is that portion of the gross area that can be exploited for economic purposes. Under asset exploitation, this will begin at an efficient level but will depreciate without intervention as buildings become functionally obsolete. Under repositioning this will likely be of medium to high efficiency as landlords will be able to reposition their asset to attract new office demographics; the serviced office model is an example of this strategy. Under renewal, the net internal/useable area will likely be high, as an appraisal of the most efficient spatial use will inform the eventual reuse option. Under removal and redevelopment, the net internal/useable area will also be high, as provision will likely be made to maximise the value of new development. It is worth noting that the measurement of net usable area is now subject to the new international code of measuring practice. The

Strategy	Asset exploitation	Repositioning	Renewal	Removal
Valuation method	Investment	Residual	Residual	Residual
Gross floor space	As existing	As existing	Better if there is elasticity	Depends on new project
Net internal/useable area	Initially high but depreciates without intervention	Medium to high	High	High
<i>Occupational demand</i>	<i>Initially high but depreciates without intervention</i>	<i>Medium to high</i>	<i>High</i>	<i>High</i>
<i>Market rent</i>	<i>Initially high but depreciates without intervention</i>	<i>Medium</i>	<i>High</i>	<i>High</i>
<i>Yield/rate of return</i>	<i>Initially high but depreciates without intervention</i>	<i>High</i>	<i>High</i>	<i>High</i>
Intervention cost	Low, associated with general maintenance	Low to medium	Medium to high	High
Intervention programme	None	Low to medium	Medium to high	High
Contingency and risk	Low	Medium	High	Low

Italic type indicates the most important factors influencing any management strategy.

Table 2
The economics of intervention

new code has been designed to remove the variation between different measurement techniques and conventions and may have implications for properties that have not been appraised recently.

Occupational demand. Under the asset exploitation strategy, demand will presumably be high in the first instance (especially if there are pre-lets in place), but this will depreciate without intervention. Under the demand repositioning, renewal and removal and redevelopment strategies, demand will likely be high, as any repositioning strategy should be exploiting recent changes in the nature of occupier demand. Research participants indicate that the end user, their requirements and what they are prepared to pay for a product in a particular place, and at a particular time, is a fundamental requirement in determining the economics of any obsolescence strategy. This is because the economics of intervention is predicated on a derived demand, and if this does not exist, or is not adequately catered for, the building intervention will fail.

An appraisal of occupier demand at the earliest possible opportunity will allow the progression of the intervention to be targeted with the purchaser/tenant in mind. This is because the viability of the intervention will depend on the relative characteristics of the office and potential alternative user markets, as well as the actual cost of intervention. Our research indicates that in certain instances, as end users become more discerning in their demands, any intervention needs to be able to compete with the characteristics of a new-build scheme. Otherwise the potential return on investment will be compromised (this is particularly prevalent in prime, central areas). However, a leading developer indicates a positive aspect to this challenge, specifically in relation to transformation into alternative use:

“If you can get the pitch right, with high-quality internal and external finishes and good ancillary uses, the product will be attractive to funders and investors.”

Leading developer

Different vacancy strategies will have different potential end users, which will vary according to contingent circumstance. For instance, the repositioning strategy, particularly the serviced office model, reflects the new/small business environment, which necessitates flexibility, adaptability, agility, ease of entry and exit, and a sufficient range of services and products to provide security and comfort, rather than the spectacle of high value. It is a model that is increasingly challenging traditional office conventions and can trace its lineage to the first business centres in the 1970s.

Yet the end use is not always defined by an appraisal of occupational demand. It can also be driven by the availability of financial incentives. This is particularly evident in relation

to the already mentioned Business Premises Renovation Allowance. This policy specifically precludes the conversion of such premises into residential use, or purpose-built student accommodation, hence the proliferation of hotel conversions in certain town and city centre locations.

Market rent. Initially, under the asset exploitation strategy, market rent will be high, as the building is new, associated with the prime market and presumably aligned with the requirements of demand. However, this will depreciate without intervention as a given building deteriorates. Under repositioning, the market rent will likely be of medium value, as any strategy will likely target a different type of market, such as business start-ups and the small business community. Although these businesses do not pay as much rent, they do offer the opportunity of filling a building and maximising the net saleable area. Under renewal, the market rent will likely be high, as the best value reuse option can be targeted. Under removal and redevelopment, rent will also be high, again because buildings can be directed toward the most lucrative demand profiles.

Yield/rate of return. Under asset exploitation, the rate of return a landlord or developer will make after the cost of intervention and/or acquisition will initially be high, but this will depreciate without intervention as a given building becomes less attractive to tenants and rent quantum and value recede. Under repositioning, the rate of return can be recovered through repositioning strategies, which do not necessarily require major cost intervention. Again, the serviced office model is an example of this strategy: intervention methods are often superficial, dealing with aesthetics and comfort, rather than major structural change. Under this model, it is about the service that is provided by the landlord rather than the physical building. Under the renewal strategy, the rate of return can be maximised as the most lucrative alternative use can be targeted in order to counteract the cost of intervention, thus protecting and potentially increasing the overall rate of return on the original investment. Under the removal and redevelopment strategy, the rate of return is lowest because of the high cost and time associated with intervention.

Intervention cost. Asset exploitation is low impact because the asset is relatively new during this period, mostly involving routine maintenance. The cost ratchets up during demand repositioning as this will involve the first stage of physical change and rebranding. However, the cost will be relatively low as the basic function is retained. A renewal strategy will likely be medium to high cost, as it will generally involve fundamental change to a building's physical characteristics, although this is somewhat mitigated if the building in question has assistive characteristics. Any removal and redevelopment strategy will also involve high cost, as any project will involve demolition, potential remediation and then rebuild.

Intervention programme. The intervention programme is the length of time for which an office building will not be providing a rate of return and the length of time for which contractors need to be paid to carry out scheduled and planned works. This issue is not applicable under asset exploitation as there is no need for an intervention programme, or any work can take place during occupation or as part of the lease renewal process. Under repositioning, the intervention programme increases, although it is still relatively light, further indicating

the convenience of this strategy as a prelude to more extensive intervention in the future. Under the renewal strategy, the programme is more complicated as physical intervention is necessary. However, because preliminary investigations are not necessarily needed for such projects, and because recent changes to Permitted Development Rights have reduced the need for planning, the intervention programme can be relatively short. Under the removal and redevelopment strategy the intervention programme is lengthy, as the degree of physical works will be great, planning approval will be necessary and repeated preliminary investigation will be essential.

Contingency and risk. Contingency and risk, relate to the value of contingency and project tolerance that needs to be built into the respective obsolescent building strategies in order to mitigate against unforeseen circumstances and delay (it also acts as a proxy indicator for the overall risk associated with each strategy). Under asset exploitation, the level of contingency is relatively low as the degree of intervention is minimal. However, this is a relatively short-term assessment of risk as it does not value the potential loss associated with doing nothing. The level of contingency increases under the repositioning strategy as the degree of physical intervention increases. However, the value of contingency will increase if additional physical structures are being added or unwanted structures removed.

The contingency and associated risk is highest for the renewal strategy as there are considerable unknowns involved in converting a building into alternative use, which are often only discovered during physical works. This can mean considerable reliance on preliminary valuation at project initiation and the need for stringent cost control throughout the project as progressive architectural instructions mount up. During this process, there is considerable risk that the actual cost of the project will diverge from the original preliminary valuation.

Reflecting this situation, it can be more difficult to acquire development finance for conversion projects. This can also fuel an incorrect perception that renewal projects are more expensive, ruling such projects out before meaningful appraisal. The removal and redevelopment project contingency is relatively low as the degree of risk in new building construction is relatively well known and can be mitigated by standardised work practices. However, the project risk can increase substantially if the nature of demolition is complicated and the presence of harmful materials is either high or unknown.

MOST IMPORTANT FACTORS

Our research indicates that the most important factors influencing any management strategy are (rows 4–6 in Table 2):

- occupational demand
- market rent
- yield/rate of return.

This is because these central requirements define, in the first instance, whether a target market exists (and its specific requirements), how much rent it is willing to pay to underwrite the cost of intervention, and how much financial return can be generated from the intervention. Importantly, our research indicates that these considerations override any physical characteristic of obsolescence.

SOCIOLOGICAL ISSUES

Research participants indicate that several sociological issues are prevalent in any consideration of obsolescent office building intervention, including ascertaining end-user requirements (which cross over into the economic section), overcoming a bias in relation to new development and the stigma toward old buildings and the general importance of vision and appetite. Research indicates that end-user requirements must be considered before any intervention. This may seem unduly simplistic in its assertion; however, there was consensus that the end user was regularly ignored in any intervention decision. In addition, there was agreement around the issue of bias toward new development and the assumption that it is a superior product in comparison to the stigma associated with older office buildings. This was particularly prevalent in relation to buildings constructed during the 1960s and 1970s. Buildings constructed during the pre-war period were perceived to have more cultural appeal, which could form part of a business or alternative use brand strategy.

Finally, our research indicates the importance of vision and appetite in relation to alternative ways of utilising office buildings. Next to economic considerations, the presence of demand and the physical nature of buildings, research participants highlighted that this issue was a primary ingredient in obsolescent building intervention. Intuitively related to the attitude of developers, this issue has been placed in the sociological segment because our research relates this to something wider than mere architectural design or working practices. Rather, it is associated with the need for society to subvert traditional ways of working and explore disruptive alternatives to orthodox practices.

TECHNOLOGICAL ISSUES

Technological issues fall under the rubric of the physical building and its location. The main issues, although variable for different eras of development, include the size, height and depth of the office building space, the office building's structure, envelope and cladding, and its internal layout and divisibility. In addition, access, building services and the provision of acoustic separation are important factors in any intervention strategy. The means of fire escape, aesthetics and image, location and accessibility should be considered when appraising potential intervention.

However, technological issues are not restricted to the building and can also be seen in the wider macro-environment. For instance, the rapid changeability of ICT has the capacity to radically alter the potential of obsolescent office buildings. Indeed, 4G wireless technology (and the rapidly emerging 5G wireless technology) is beginning to negate the need for disruptive servicing retrofits and the demand for large floor-to-ceiling heights. Our research indicates that the discerning user increasingly values the ability to simply plug in and work (and play). Therefore, technological issues should not only be centred on the individual building and the ability for it to change, but the perspective should also be cognisant of the wider technology-based changes in the nature of work and the opportunities these present.

LEGAL ISSUES

Research participants indicate that there are two major types of legal issue in relation to mitigating office obsolescence: building-related issues, and ownership- and lease-related issues. The building-related issues are closely related to the political segment but are included in the legal section because they are related to the legalities of statutory building regulations and planning policy guidance. First, any alteration to an office building must consider access, fire safety and the equalities Act. Any change to a building, especially when it relates to a change in use, will need to be cognisant of the relevant building code for that type of use, the Use Class Order and potential flexibility around Permitted Development Rights.

In addition, any invasive intervention measure must check whether the building is listed and/or if it is located in a conservation area. Depending on the nature of historic architectural listing, both internal and external parts of buildings can be protected and must be checked over by an historic building expert. This issue is particularly prevalent in the pre-war office era segment. Although historic listing can add to the cultural appeal and brand image of a building, it can also add significant cost to intervention, and should therefore be factored into any economic appraisal. In addition, the relaxation of Permitted Development Rights does not apply to listed buildings, so any internal or external alteration would necessitate a Listed Building Consent. Yet, there are some positive aspects to listed building status. Such buildings are exempt from empty property rates and do not require an Energy Performance Certificate, which exempts them from the 2018 Minimum Energy Efficiency Standards (MEES). The other side to this argument is that these exemptions could remove some of the incentive to intervene in an underperforming property asset.

Secondly, the current ownership and tenure/lease situation must be assessed when considering an intervention. If the building is covered by a single tenancy, intervention can take place at the end of the lease relatively smoothly, as the landlord will have vacant possession. However, it is common for office buildings to be subdivided and let to multiple tenants, thus necessitating some form of rationalisation and compensation strategy. A phased programme of works could be considered in less intensive intervention strategies, such as the adding of additions under the repositioning strategy (this strategy is less likely under renewal). Furthermore, the delicate issue of who pays for various interventions in obsolete office buildings – the tenant or the landlord – is an obvious concern. A similar situation is evident in relation to MEES, in other words is it possible for landlords to pass on the cost of building improvement to the tenant. In principle, it could be possible for landlords to pass on the physical cost of asset exploitation and demand repositioning to the tenant as it resembles fit-out and maintenance negotiation – this is certainly the traditional approach. However, it is more difficult to envision tenants wanting any involvement in the asset renewal strategy and, increasingly, asset exploitation and demand repositioning, as tenants become more discerning in what they sign up to during lease negotiation or pay for through service charges.

ENVIRONMENTAL ISSUES

Our research indicates that environmental issues predominantly relate to hazardous materials. Older buildings are more likely to have hazardous materials present, such as asbestos, which is costly to remove. Furthermore, the surrounding site is more likely to be contaminated, and may therefore necessitate significant levels of preliminary investigation and consequent remediation if the wider site is included in any intervention strategy. ■



Removal of asbestos
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HOW CAN OFFICE LANDLORDS AND INVESTORS CAPITALISE ON THE NEW WORKING ENVIRONMENT?

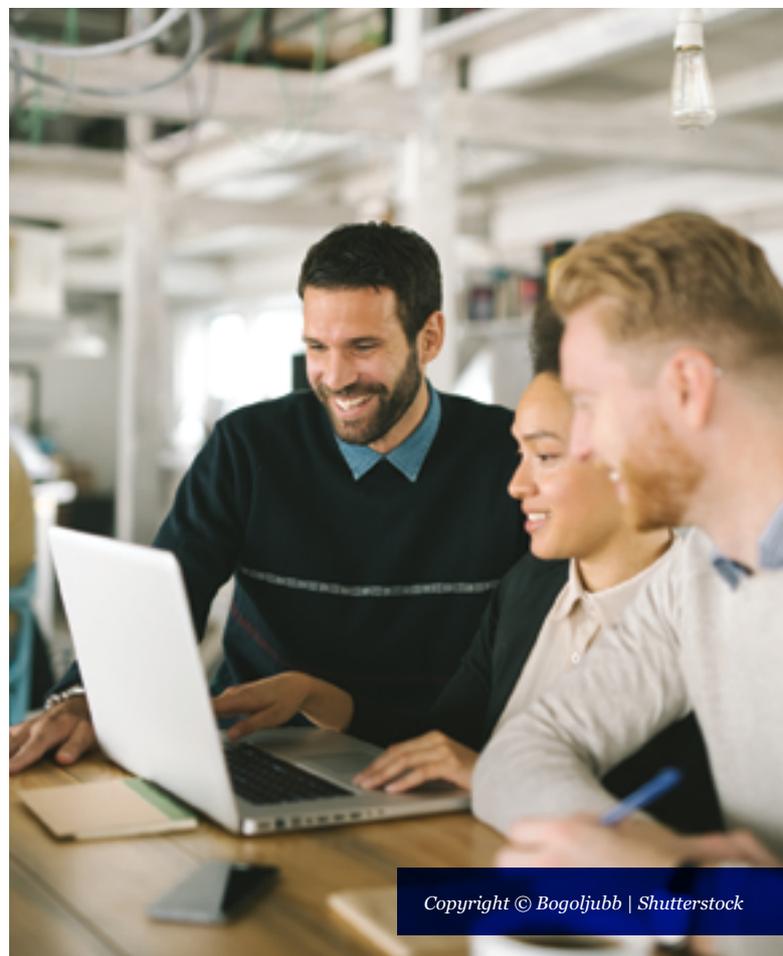
A CALL TO ARMS: THE AGILE MANIFESTO

When researching obsolescence, one word emerges frequently: agility. Contemporary business is agile and fleet of foot. New start-ups are nimble, energetic and agile. Yet, office buildings (and landlords and professional advice) are often the opposite, slow and lethargic, clinging to the comfort (and security) of the traditional long lease. In response, we put forward the challenge of office building agility – that investors, landlords, designers, regulators and the institutions of the office market, need to be increasingly nimble in their respective office building strategies. They need to show dexterity in the face of dynamic change and alacrity in the face of enduring market inertia. The aim of this is to provoke the recasting of commercial real estate institutions around notions of flexible and continual building reuse.

Concepts of agility are starting to take root in the ICT, organisational change and project management disciplines – in other words, everyone who uses offices. All three disciplines are traditionally unrelated to commercial real estate development. However, all three can be used as a proxy for the way that the business community is changing and can help inform how the office market needs to change accordingly. Office building agility borrows terminology from software, organisational development and project management methodologies, arguing that the office market has much to learn from these disciplines. All three spheres of business have embraced change as an integral part of the development process. Indeed, software systems and organisations are now being designed to continue to operate in tandem with changes in user requirements, legal regulations, market opportunities, usage settings, locality and network connectivity.

In addition, the expectations of end users with regard to personalisation and customisation are increasingly critical to market success. Obvious parallels can be drawn with the dynamic nature of occupier demand and the often restrictive nature of office supply. Not only can software and organisational development be used as a critical metaphor for commercial office supply, it also reflects the flexible ways in which business now expects to operate. This flexibility is something which office development is not always very good at supporting.

In 2001, 17 of the biggest software developers came together as the Agile Alliance to sign the Agile Manifesto,⁴² which contained a list of ideas and principles that were often discussed but rarely voiced in open debate because they contradicted the orthodox institutions of systematic development. Since then, the Agile Manifesto and its adjunct, the Declaration of Independence, published in 2005,⁴³ have strongly influenced software and organisational development. In line with the principles outlined in both documents, it is possible to sketch a basic agile manifesto for the commercial office market and its institutional environment:



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- Uncertainty in office use is to be expected and managed through iterations, anticipation and adaptation.
- Office building productivity is maintained through situationally specific strategies, processes and practices.
- Agility and adaptation is prioritised over conformity in building use and spatial strategy.
- Changing requirements are welcomed; agile processes harness change for competitive advantage.
- At regular intervals, user demand should be assessed, leading to the fine-tuning and adjustment of office development and management.

Office building agility argues that repeated temporary use should be considered the norm in conveyance. Even though office buildings are traditionally designed to last for centuries, they will have multiple tenants and types of use. In the future, office buildings may not be judged only on specification. They may not even be called offices, but business centres, hubs, communities or hives. What is certain, is that the ability to adapt and change will be a key determination of success and profit.

CONCLUSIONS

SUPPORTING INFRASTRUCTURE

In addition to the agile manifesto, there are several institutional improvements that could aid the office sector adapt to the new requirements of business. These are summarised below:

A COHERENT GOVERNMENT PROPERTY POLICY

The list of policies that either directly or indirectly influence the office sector is lengthy: business rates, empty property rates, Permitted Development Rights for conversion, listing, minimum energy performance regulations, building regulations, planning policy and incentive schemes such as the Business Premises Renovation Allowance. All of these policies need to be aligned and publicised in order to support the office sector. An illustration of the confusion that surrounds government legislation can be illustrated by looking at Minimum Energy Efficiency Standards (MEES). The message is starting to get out that any building with an EPC rating below E is under threat of legal obsolescence (although this is still ignored by many landlords). However, changes in the underlying Energy Performance Certificate (EPC) methodology, the Simplified Building Energy Model (SBEM),⁴⁴ are less well known – they have led to a revision, which can increase, or decrease an EPC rating. Many EPCs were assessed under the old methodology, and the implication is that many landlords may be either unaware of potential liability or unwittingly improving their buildings when they do not need to because the original assessment was unduly negative.

THE NEED FOR AN AGILE PROPERTY ACCREDITATION GUIDELINE

BREEAM,⁴⁵ RICS guidelines on the SKA rating⁴⁶ and indeed the BCO *Guide to Office Specification*⁴⁷ exist to appraise building design, specification and fit-out. Each is successful in laying down a set of good-practice principles for mainly physical building attributes. A wider accreditation strategy that includes the ability of a building to adapt and change to tenant requirements may go some way to convincing landlords and investors to change their traditional practices. Research indicates that the physical aspects of agility, and indeed the professional practice that can support this (e.g. flexible responsive lease management), is relatively well known. Yet, these practices are still not adopted. This suggests that there is an inertia associated with professional practice, which could be altered through accreditation.

THE REQUIREMENT FOR HOLISTIC EDUCATION (PRE-AND POST-PROFESSIONAL QUALIFICATION)

Professional practice typically starts in education. There is a clear requirement to refresh many of the traditional principles taught in university real estate departments. This content is often based on assumptions of a perfect market, but 2007–2008 proved that this market does not exist. We need to combine traditional real estate education with an appreciation of contemporary business studies – in particular research into disruptive innovation. If ever there was a market ripe for disruptive innovation – the office market is it. The office sector needs to protect itself by adopting new flexible principles in its management strategies, and this is as equally true for designers as it is for managing agents and investment portfolio managers. ■

This report began by setting out the context for, and current research in, office obsolescence. It then delineated four vacant office building strategies – asset exploitation, demand repositioning, asset renewal, removal, and redevelopment – which reflect the downward trajectory of the property ladder. Each strategy has an associated set of management techniques and a relative degree of intervention. A PESTLE analysis was undertaken in order to explain the contingent ingredients that go into any obsolescence-mitigation appraisal. The findings suggest that the primary imperative for economic viability is criss-crossed and undercut by additional issues of politics, relative rental structures and sociological, technical, legal and environmental conditions.

We then built the case for office-building agility, arguing that repeated temporary use should be considered the norm. Even though office buildings are traditionally designed to last for centuries in the physical sense, they will have multiple tenants and types of use. In the future, office buildings may not be judged only on specification; they should be marketed as a service, rather than as an asset. Under this perspective, investment and management strategies will need to be proactive, with an emphasis on tenant experience. This suggests a change in approach from traditional management strategies based on price signal. Assets may not even be called ‘offices’, but business centres, hubs, communities or hives. What is certain, is that the ability to adapt and change will be a key determinant of success and profit in the future ■

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